RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 3, 1996 **LETTER 1203**

THE MARKET: "To conquer the beast, you must first learn to love it" -- Ancient Chinese proverb.

What did the Chinese mean? The proverb means that in order to conquer any area, you must first learn to respect it, to appreciate it, to learn all you can about it -- even to be obsessed with it.

No truer words can be spoken regarding the stock market. For instance, to operate successfully in a bull market you must respect the power and the persistence of the primary trend. That means that regardless of any personal prejudices, you must not fight the primary trend; rather you must appreciate it and, yes, even learn to love it. Furthermore, you must learn all you can about a bull market -- its strengths, its weaknesses, its particular characteristics, how it compares with previous bull markets, how it differs from previous bull markets.

All bull markets (and bear markets) can be reduced to a single equation -- supply vs. demand. All the positive forces are distilled into the demand side. All the negative forces are distilled into the supply side.

To my mind, the current great bull market is now moving into perhaps its most fascinating phase. It's moving into the phase where supply is slowly but relentlessly catching up with demand. Following are some of the items I consider critical:

(1) The market has been overvalued for the last four or five years. I base this on dividend yields, book values, price-to-sales ratios, and the relationship of stock yields to bond yields.

(2) The market has not had a 10% correction for six years (since July-October 1990), the longest time span in stock market history.

(3) This is the oldest bull market in history (it started on October 3, 1974).

(4) It's been 14 years (1982) since we've had a Dow low that was below the low of a preceding year's low. By the way, last year's Dow low (1995) was **3832.08.** If the Dow was simply to drop below last year's low, the Dow would lose roughly one-third of its value.

(5) The S&P 500 has risen on 17 out of the last 19 months. This extraordinary display of upside action must have discounted a great deal of bullishness potential (the month of June, surprise, was a down month).

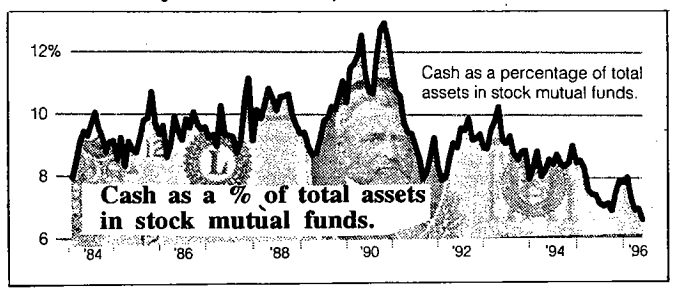
(6) Public participation in this bull market is the greatest in history (through direct purchase of stocks or through mutual funds and investment clubs).

(7) Equity mutual fund cash as a percentage of total assets has dropped to a 19-year low of 6.7%.

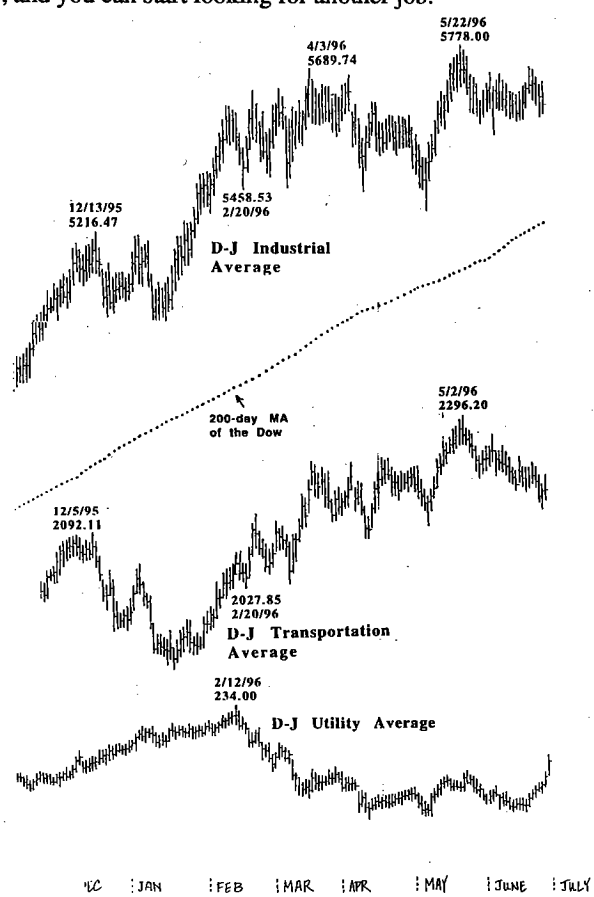
Every bull market contains basic common characteristics, yet each possesses its own peculiarities. I think the current bull market will go down in history as the "mutual fund bull market." Money continues to pour into equity mutual funds at the staggering rate of over $20 billion a month.

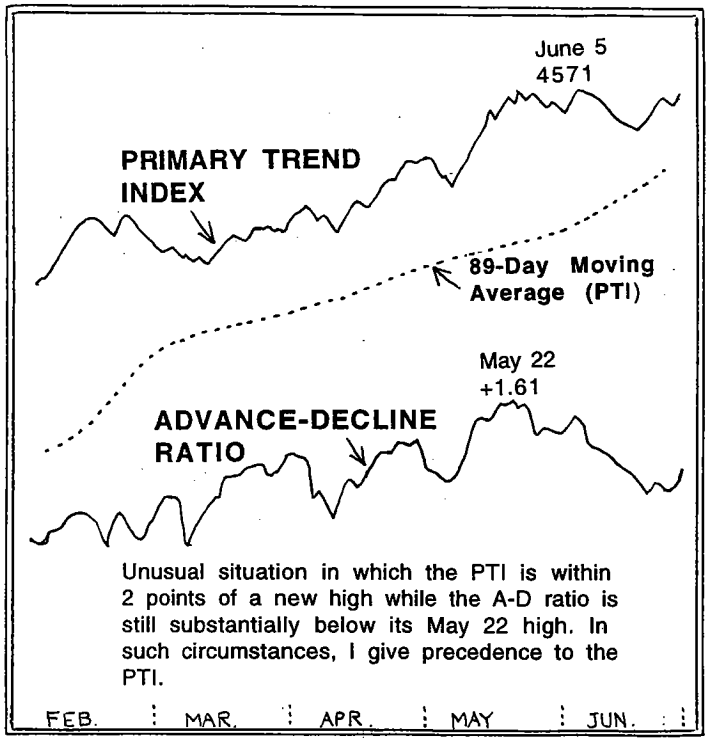
The fund managers realize that when people buy an equity fund, they want that fund's money to be invested in stocks (not bonds or cash). Thus, the fund managers became equity allocators. All new money went into stocks; it was simply a question of which stocks or which groups.

June 21 DJIA 5705.23; PTI 4556; A-D Ratio +0.22
June 28 DJIA 5654.63; PTI 4567; A-D Ratio +0.51
Dow Yield: 2.19%; Dow Price/Earnings: 18.1
Dow 200-day MA: 5293; Dow 30-day MA: 5686
Dow Times Book Value: 4.22; PTI 89-day MA: 4516
Percentage of Undervalued Blue-chips: 3%
Gold 200-day MA: 393.09; Gold-PTI: 502



I thought the exit of Jeff Vinik of Fidelity's Magellan fund was very significant. Vinik loaded up with bonds and his fund lagged the S&P. What happened next? Vinik was "relieved of duty." The moral of the story -- if you're a fund manager, you buy stocks and you beat the S&P or else. If you beat the S&P, you remain on the job. If you lag the S&P, watch out. Furthermore, if you allocate to other than common stocks, you're not doing what you were hired to do, and you can start looking for another job.




June 5
4571
PRIMARY TREND INDEX
89-Day Moving Average (PTI)
May 22
+1.61
ADVANCE-DECLINE RATIO
Unusual situation in which the PTI is within 2 points of a new high while the A-D ratio is still substantially below its May 22 high. In such circumstances, I give precedence to the PTI.
FEB.
MAR.
APR.
MAY
JUN.

But what if a bear market emerges, and your fund heads south? Well, when your fund goes down, so does everybody else's fund, so why worry, they can't fire a thousand mutual fund managers, can they?

So now we have a bull market in which mutual funds have invested hundreds of billions of dollars in all types and varieties of stocks. The fund managers are not thinking in terms of protecting their funds from a bear market, and with a very low position in cash they are not positioned to withstand a bear market. Maybe a bear market will never arrive -- but if one does come, as I said, we'll be presented with a very fascinating picture.

Notes: Many analysts use a company's price-to-sales ratio as a measure of value. For instance, a low price-to-sales may mean that a company is bargain priced, while a very high price-to-sales may tell us that a company is priced too richly. Marty Zweig, in his latest report, applies this reasoning to the broad S&P 400 Industrial Index. According to Marty's figures, the price-to-sales for the S&P 400 now stands at 4.54, a record high (since 1969). By contrast, at the lows of 1974 and 1982, the P/S ratio was below 1.5. Thus the P/S is now better than triple what it was at the lows. Marty notes that historically when the P/S ratio was above 3.5 the market lost 1.8% a year. States Marty, "I realize that the high ratio today implies that profit margins (on sales) are very high, thanks to all the corporate cost cutting. But what are very high or possibly peak margins worth *(Zweig Forecast,* Box 360, Bellmore, NY 11710)?

CURRENT MARKET SITUATION: In the last Letter I noted that selling pressure in this market turned up on a trend basis last September. Then five months later, in February, buying power turned down on a trend basis. Once this happens, I wrote, there is usually a period of four to six months before selling overwhelms buying power (based on the *Lowry's* studies).

Four to six months -- that puts the probability of *major* trouble starting sometime between now and August (giving it leeway, let's say, *before* the November election).

Action over the past two weeks has been poor and hardly typical of the powerful action that we have seen throughout most of 1996. Declines outpaced advances on many days, new lows outpaced new highs on many days, and even on several days when the Dow was up the advance-decline ratio was down. Last week the number of NYSE stocks holding above their 200-day moving average declined to 59%, the first under-60% day of 1996. Many tech stocks and sundry issues have been hit and hit hard -- and the latest word is, "Be safe, buy the big-brand names."

Referring to the chart at the left, note that the **advance-decline ratio** peaked back on **April 22** and it has been in a sustained downtrend ever since. The disparity between the Dow and the advance-decline ratio is now substantial and rather ominous. Probably the worst action from here would be a Dow rally to a new high above **5778.00** with the A-D ratio continuing to lag or even diverge.

My **Primary Trend Index (PTI)** hit its high of 4571 on June 5. It declined for a few weeks, but by Friday of last week the PTI had advanced to within 2 points of its June 5 high. No signs of weakness on the part of the PTI.

Interpreting the PTI: (1) The first suggestion of potential trouble in the PTI is simply a declining trend. **(2)** A bear signal is rendered when the PTI breaks decisively below its 89-day moving average. **(3)** A final bearish confirmation occurs when the PTI's 89-day moving average itself turns down. We have not seen the moving average declining since October 1994.

For those interested in cycle history and election year statistics, consider the following. Referring to the "decennial cycle," all four presidential election years ending in "6" were bullish years, but all four of those "6"s were followed by rotten markets during the following "7" years.

The year **1916** (Wilson) saw an irregularly higher Dow, with a slump towards the end of the year. But in January 1917 the Dow, starting at 105, headed down and by December the Dow had struck a low of 64. The year **1936** (Roosevelt re-elected) was followed by the severe 1937 bear market, in which the Dow fell by 49% within a matter of months. In **1956** (Ike re-elected) the Dow hit the 520 level twice, then in 1957 the Dow dropped rapidly from a July high of Dow 520 to an October low of 419. The year **1976** (Carter) was a good market year -- followed by a Dow high of 1004 in January 1977, then a long, costly decline to 744 in March 1978.

So you have to wonder, will the bullish (so far) year **1996** be followed by a disastrous year 1997? My own feeling is that this market will be very lucky to get by 1996 without major trouble. If it does get by 1996, I'd put a high probability on a primary bear market starting in 1997.

Question: The stock market up to now has been extremely responsive to lower interest rates. But what about last week's action? With bonds rising, with commodities sagging, and with the market not responding to the rallying bonds, you have to wonder. Could the markets (stocks, bonds and commodities) be discounting a business downturn before the election? Now there's a thought -- and a contrary thought at that.

RUSSELL COMMENTS: I have written previously that what the bear (as in a bear market) wants -- is to take the market down with as many investors as possible remaining on board. In order to do this, he has to keep stockholders "hanging on and hoping." Thus, a crash or a frightening collapse will hardly serve. No, if a bear market was to enter now I think we would see a period of erosion, a period where certain groups collapse while others hold or even rally. It would be a market of revolving weakness, a process that would allow most stockholders to "hang on and hope," while the losses accumulate.

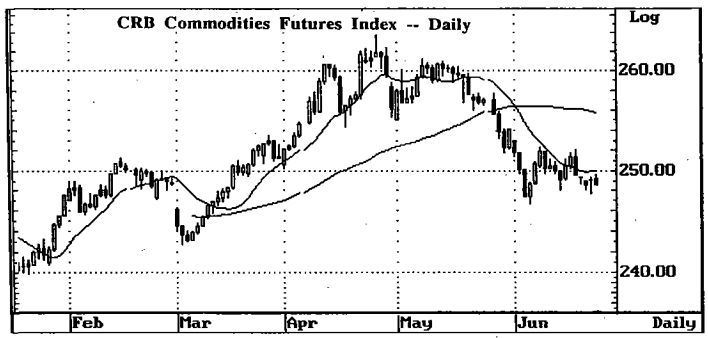
The June 27 *WSJ* headlined an article, **"Strong Summer Rally, Then a Plunge, Predicted by Four Technical Analysts."** Maybe, but that sounds too pat to me. A strong summer rally would allow all those sophisticated analysts (and their followers) to

exit the market handily. If, and I say IF, a bear market is just around the corner, it's not going to happen that way.

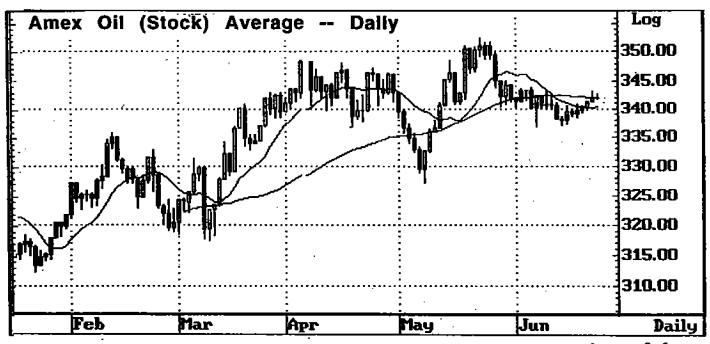
CHARTS TO PONDER: Another question that comes up -- if business contracts (and of course that's just an "if") would the contraction be accompanied by deflation? The consensus opinion, of course, is that if any danger lies over the horizon, that danger is inflation. So one has to wonder, is deflation even a remote possibility?

I think it is (you may remember that the markets love to double-cross the majority). With that thought in mind, let's study a group of interesting, or should we call them tell-tale charts.

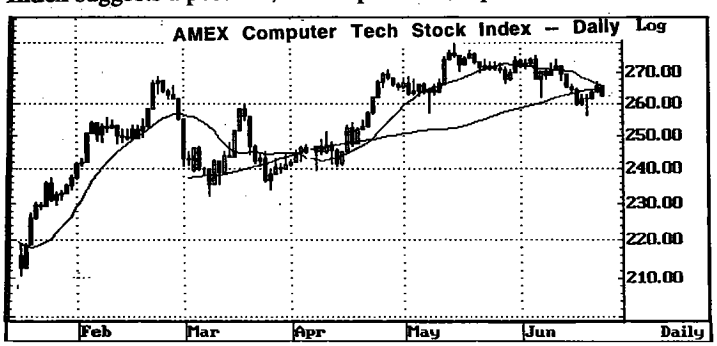
First, the **CRB Commodities Futures Index.** From an April extreme high of 263.79, this widely-watched Index has dropped to the 240s. This represents a drop of 9%, hardly a catastrophe, but at the same time hardly a forecaster of inflation.



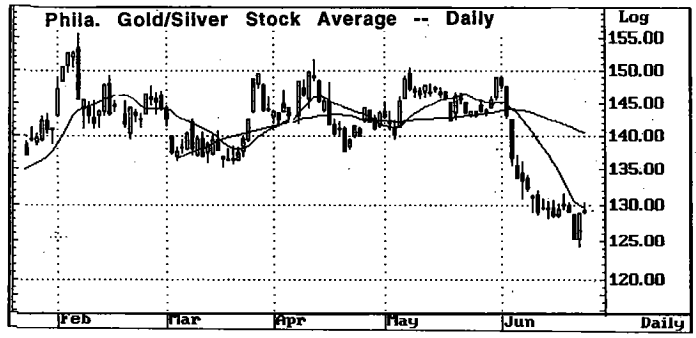
The **AMEX Oil Index** appears "toppy," and of course, oil is one of the major components of any inflation forecast. Much of the oil fluctuations are blamed on Iraq and the odds of that rogue nation starting to export oil. The spot oil price is now just over 20 but the future months are in the 18 area. No hysteria in the market to buy oil.



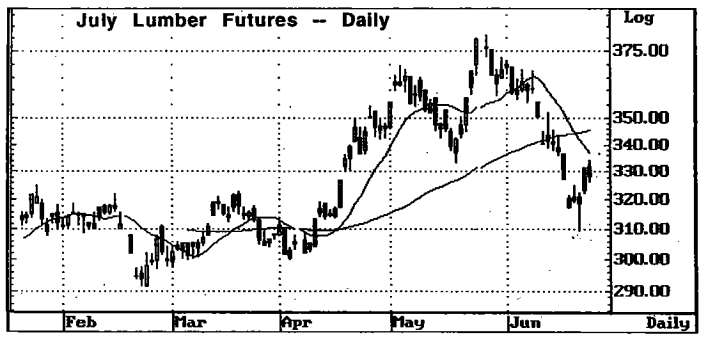
Computers and "tech" stocks have been the glamour section of the stock market. This daily chart of the **AMEX Computer Tech Index** suggests a possible, even a probable, top-out in this sector.



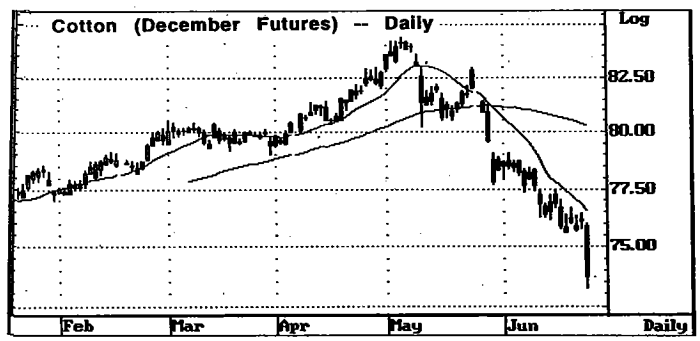
The **Phila. XAU Gold/Silver** stock average suggests deflation, not inflation. Few items are more sensitive to inflation/deflation than the precious metals. Inflation? You just don't see it in the XAU.



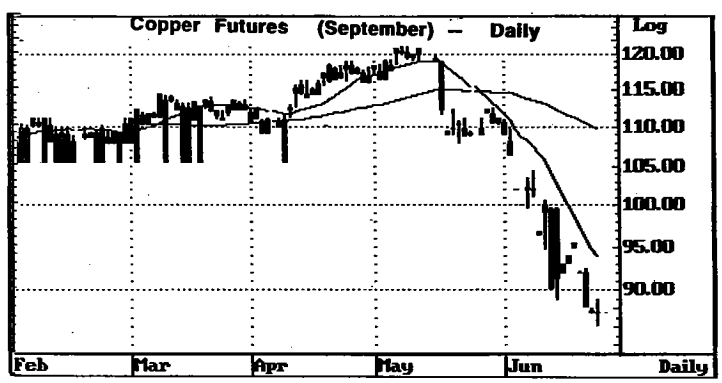
Building boom? Not as far as **Lumber** is concerned. This chart shows lumber swooning from a high over 375 to a June low of 310 -- then a recent "dead-cat" bounce. Lumber isn't reflecting any inflationary boom in housing.



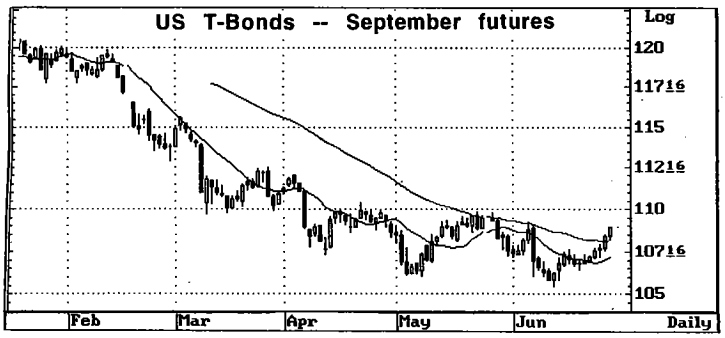
Cotton (Dec. futures) has collapsed from a May high of 84 to last week's low in the 73 area. Check the Cotton/Copper comments in the next paragraph.



Copper, "the metal with a Ph.D. in economics," is widely-watched as a harbinger of economic activity and inflation/deflation. Copper has recently collapsed to the 84 area, and, of course, the collapse has been blamed on "that rogue trader out of Sumitomo." Maybe, maybe not. Steve Briese, the sophisticated editor of the *Bullish Review* [(612)423-4900] in his latest report notes that ***"turns in both Cotton and Copper have accompanied many important stock market tops -- far more than coincidence alone would explain (except to a bull wearing blinders)."***



Lastly, this is a chart of the September T-bond futures. From the June low of 105-16, the bonds have rallied to the 109 area. An important upside breakout would come at above 110. Admittedly, this rally could represent a mere corrective-bounce, a reaction to the severe earlier 1996 decline. But then again, the bond rally could also represent the bond market's discounting of recessionary conditions later this year (with accompanying lower interest rates). Interesting picture!



INVESTMENT POSITION: In the last Letter I presented the critical upside targets that we should all be watching. These targets are the bull market highs recorded this year. For the D-J Industrial Average there's the record high of **5778.00.** For the Transportation Average there's the record high of **2296.20.** And for the S&P 500 the high was **678.51.** *For a re-confirmation of the bull market we would want all three of those marks to be bettered.*

In the meantime, you have the obvious choice of crap-shooting in this overvalued and dangerous market or husbanding your cash and assets and waiting for better times (better times to buy, that is). Note that almost all the commentators and analysts are now reduced simply to listing stocks to buy or mutual funds to buy. I was startled by the "Everyone Can Be a Millionaire" cover on the current issue of the *Reader's Digest.* Naturally, I was curious, so I immediately turned to the article inside. Lo and behold, all we have to do is buy stocks or funds on a regular basis, month after month, year after year. Gad, I never realized it was all that easy, but there it was -- right in the authoritative *Reader's Digest.*

My advice -- wait awhile. Sit tight. Curb your greed. CASH isn't TRASH, and you can lose your money in a FLASH if this market was to CRASH (or even if it was slowly to turn to HASH).

NOTES & QUOTES: How often have you heard some ignoramus insist, "The US is a republic, not a democracy?" This democracy vs. republic argument is one of the least understood areas of political theory. The original concept of a democracy was a political system where issues were put *directly to the people* on the basis of a simple majority vote. Of course, this was only possible where populations were small (such as in ancient Athens). The word democracy comes from the Greek Demos, "the people," and Kratos, "authority," or authority from the people.

Obviously, today, with populations of every nation in the multi-millions, no nation can now function as a pure democracy in the original sense of the word. Thus, when someone insists that "the US is not a democracy," technically, he is right. No nation today can function as a pure democracy. But philosophically he is wrong. He's playing on words.

A republic is a form of government wherein the people's *representatives* make the laws. Hopefully, a republic will be run on democratic principles in that the people make the laws, but indirectly through elected representatives (however, in some states, such as California, there are initiatives, and these are placed directly on the ballot and passed or killed by majority vote).

But the majority does not always prevail in the US republic (take our electoral college system, for instance, where a president can win a majority vote but lose in the electoral college).

We should remember, however that in a republic the voters still possess tremendous power, even though the majority may not always prevail. And in many cases, this is actually desirable. For instance, in the pre-Civil War South the majority undoubtedly favored slavery, but did that make it right? Today, in many cases we don't even know what the majority wants, for instance in the case of the death penalty or abortion.

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If Perot doesn't run for president, it looks as though former Colorado governor Richard Lamm will run as an independent. Lamm is a very smart, outspoken fellow. If Lamm runs, he will be talking about things neither Dole nor Clinton want to discuss, specifically, entitlements. Lamm uses a chart that resembles a steep cliff. The chart shows that the entitlement programs plus servicing the national debt will consume virtually ALL expected federal income by 2010, only 14 years from now. That means either massive new mountains of debt, wild inflation or as Lamm puts it, "No Defense Department, no national parks, no judiciary, no executive branch of government." Lamm proposes an across-the-board assault on rising entitlement costs as the key to preserving the nation's health.

The American people know that Lamm's right. They also know that the politicians of both parties are avoiding the hard choices. Lamm could be a real problem for both Clinton and Dole, but more probably for Clinton. As a guess, I expect Lamm to run, and I expect him to swing a lot of votes.

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In the meantime, in a letter to the *NY Times* (June 19) House majority leader Dick Armey writes that the current tax system "corrupts." He writes, "The lobbying industry is the largest private sector employer in Washington, accounting for fully one-sixth of the private work force -- 67,062 people. These lobbyists were paid more than $3.2 billion in '93, an average of $47,679 each. If the D.C. lobbying industry were its own economy, it would be larger than the economies of 57 nations . . . Disclosure by lobbyists reveal that the tax code is the single greatest source of lobbying activity in Washington . . . Two years ago I introduced legislation that would scrap the current income tax and replace it with a flat tax on all income. By eliminating itemized deductions and special breaks, the flat tax removes the entire playing field on which lobbyists operate. That's why a simple, neutral law like the flat tax would have a chilling effect on the lobbying industry and transform the entire culture in Washington." **Russell comment:** This, to me, is the single greatest reason for wanting a Republican president and Congress. If we get both, I think there's a reasonable chance that Dick Armey and some version of the flat tax could become a reality.

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New York magazine's (June 12) cover story headlines as follows: "Rents Get Ridiculous. Uptown and downtown, for fancy places and hovels, apartment prices have soared to insane heights." The article begins, "A mind-bending rise in rents -- 30 to 40 percent since 1993 -- is turning Manhattan into another Tokyo. What fresh New York hell is this?" **Russell comment:** Much of this is due to the boom on Wall Street and in the financial markets. And when the financial markets boom, New York booms. Example: for the first quarter, Goldman Sachs announced an enormous pre-tax profit of over $700 million.

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Money magazine (July) presents a special issue on "Best Places to Live Now." Here's how the "Biggest Places" rank: (1) San Diego; (2) Houston; (3) LA/Long Beach, CA; (4) Orange County, CA; (5) Dallas. Of the overall smaller places, it's: (1) Madison, WI; (2) Punta Gorda, FL; (3) Rochester, MN; (4) Ft. Lauderdale, FL; (5) Ann Arbor, MI.

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For the mutual funds, it's load up with stocks or else. Proof of this philosophy can be seen in the cash-to-assets ratio of the funds. The ratio has now fallen to 6.8%, lowest in 19 years. All stock, no cash, it's the order of the day.

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Don't expect Americans to totally dominate in this year's Olympics the way they have in the past. What's changed? Dozens of great foreign athletes are now training in the US, many with scholarships from sports-minded colleges and universities. These athletes are receiving superb training from the best US coaches. The outcome in this year's Olympics could be much less "US-oriented."

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The commodity world is still in shock from the incredible losses sustained by Sumitomo, losses stemming from 10 years of trading via their rogue trader, Yasuo Hamanaka. How could 10 years of wacky trading be hidden from authorities? Obviously, some people had suspicions, but the Japanese psyche does not like to admit to error. To err in Japan is shameful, so evidently nobody said anything. Result -- losses of at least $1.8 billion and perhaps as high as $3-4 billion. On June 6 copper fell 15% in just two hours of frantic trading. As this is written copper sells in the high 80s with a reputed 10-20 million ton oversupply of copper worrying the market.

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Japan has had its financial disasters, but that hasn't halted Asian hotel buying. Last week a Hong Kong investment group was close to a deal to buy New York's premier Four Seasons Hotel. In recent months, Asian interests have bought the Regent Beverly Wilshire Hotel, the Plaza in NYC, and the former Helmsley Palace in NYC.

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In Hollywood, money goes where the profits are --eventually. The current Tinsel Town trends: (1) Cut back on production: Disney announced that it will be making 30 movies instead of 60, and they will be increasingly interested in lower budget movies (those $20 million star salaries are killing the studios). (2) Animation, everyone wants to get into animation. Why? Because Disney has been making a fortune on its animation pictures. "Aladdin" earned $650 million, "Beauty and the Beast" earned about $500 million. As far as animators' salaries, that's where the action is. Animator's salaries, low in the past, now range from $2,000 to $4,000 a week with some making more than $1 million a year. If you're an artist and you're interested in money, think animation and Hollywood.

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Book after book, magazine after magazine, have been published all discussing the sleazy past of the Clintons. The latest is "Partners in Power" by Roger Morris. The book is far more devastating for the Clintons than "Blood Sport." The book is fascinating, well-written, and exhaustively researched. If you read this book you will be staggered by the sheer, relentless ambition and desire for power evidenced by the Clintons. Another Clinton book by the editor of "American Spectator" will be coming out shortly. And you wonder -- how can the Clintons survive Travelgate, Whitewatergate, Troopergate, Gennifergate, Gaygate, Fornigate, Paulagate. Draftdodgergate, Fostergate, Irangate, Cattlegate, Filegate, and on and on? And with it all, every time I turn on my TV there's Bill Clinton, talking, talking, talking. Ugh. My original thoughts were that the Americans no longer care about corruption, hypocrisy and deceit in the White House. Next, I thought Americans just didn't believe the charges against the Clintons. Now I think Americans are beginning to believe the disreputable character of the Clintons. I further believe that Dole's chances will rise substantially -- as the truth about the Clintons emerges and as their lights dim.

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It's worth getting the *NY Times* just to read Maureen Dowd's great op-ed columns. The brilliant Ms. Dowd is fast becoming the most popular columnist in the nation. Her June 20 piece, in which she tries to drag Bob Dole into the present, is a scream (P.S., she likes Dole but is worried that he's far too stodgy and fails to communicate with the very important boomers).

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Britain's Margaret Thatcher stated that she wouldn't invest a penny in either China or Russia. Why? Because neither is a nation ruled by law.

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CalPers, California's giant Public Employees' Retirement System, announced last week that its assets have climbed over the $100 billion mark for the first time. CalPers also announced that it will be increasing its investments in real estate.

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The real key to inflation is usually the trend of wages. According to the Employment Cost Index, wages for workers in private industry just recorded their sharpest quarterly increase in five years. The Fed obviously is aware of this. Therefore, expect any action from the Fed to be towards higher rates (unless, of course, the stock market tanks first -- then all bets are off).

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A Billion Dollars: The federal government has given the states more than one billion dollars in the past decade to set up computer systems programmed to collect child support. Only five states have these computerized systems running. Last year states collected only 18.3% of child support payments that were due. Rep. Henry Hyde (Rep., IL) called the results "pitiful," and stated, "This is a dismal record, and one that won't improve until the efficiency of the computer tracking system improves." **Russell question:** A billion dollars can't buy decent computer systems? Is there any accountability in government?

* *

Since 1993 China has quadrupled its foreign reserves to an amazing $85 billion, so last week China announced that it will make its currency, the yuan, more easily convertible at the end of this year (they were originally talking about 1999). This decision will make it easier for foreign companies doing business in China to do normal business with local banks and then repatriate their profits into other currencies. **Russell Comment**: Compare the shrewd Chinese business know-how with the inefficiency and corruption of Russian business.

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Savings: Equitable Life Assurance in a recent study announced that fewer baby boomers are saving for the future, and those that do save are saving less. Nevertheless, boomers are increasingly optimistic regarding their financial future and are more confident about their investing prowess. The latter has caused boomers to take on more risky investments. **Russell Comment:** Boomers have never lived through a bear market. A bull market makes heroes of us all.

* *

Revised Version: Clinton advisor George Stephanopoulos talking about Craig Livingstone, former director of the White House office of personal security who was put on leave for his role in the FBI files. Before: "He does a terrific job. All I know is that anything that has to do with security or logistics, Craig's going to take care of it. You don't have to tell him how to do it." After the news of the FBI files: "I don't know him that well. He's a guy that was around . . . I never worked with him on a campaign, but he seemed competent. What can I tell you?"

* *

When I first started Dow Theory Letters, fashion (even most textile firms) was considered highly speculative and unsuitable for conservative investors. Times have changed. Here's a run down of IPOs in the fashion business over the last year, courtesy of *Women's Wear Daily*.

Initial Public Offerings from June 15, 1995 to June 14, 1996

Company	Date completed	Proceeds to company	Proceeds to shareholders	Price at offering	Price at 6/14
Tarrant Apparel	7/95	$18M	-	9	10 3/8
Oakley	8/95	$75.9M	-	23	42 1/2
Gadzooks	10/95	$19.3M	$9M	14	33 1/4
Intimate Brands	10/95	$680M	-	17	24 3/8
Gucci Group N.V.	10/95	$539M	-	22	70 3/4
Estee Lauder Co.	11/95	$11.3M	$386.8M	26	40
K&G Men's Center	1/96	$10M	$7M	10	20 1/2
Mossimo	2/96	$54M	$18M	18	42 1/8
Revlon	2/96	$180M	-	24	29 3/8
Marks Bros. Jewelers	5/96	$45.5M	-	14	23 1/8
Loehmann's	5/96	$60.7M	-	17	23 5/8
Designer Holdings	5/96	$101.4M	$101.4M	18	27 1/2
Blue Fish	5/96	$4M	-	5	7 1/4
Saks Fifth Ave.	5/96	$376M	-	25	33

* Proceeds are in millions and before underwriting discounts and commissions.

GOLD: In the last Letter I presented the case for deflation. I based this not so much on my personal instinct or belief but simply on what's been happening.

Commodities have been sliding. Copper (admittedly due, at least in part, to the Japanese scandal) has slumped below 90 cents. The grains and corn all appear to have topped out. Retail stores are facing intense competition and are finding it difficult to raise prices. And all this is happening within the context of a bull market on Wall Street. One wonders what would happen if a primary bear market were to take over.

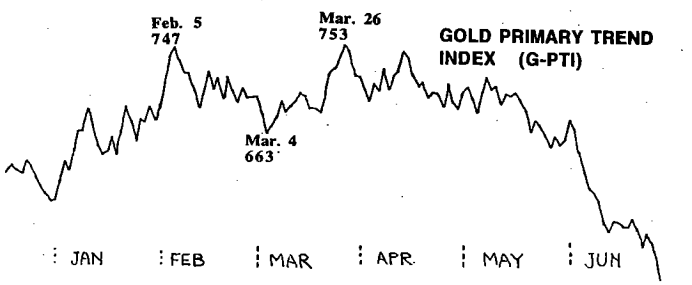
The precious metals seem totally disinterested (at least so far) in the threat of inflation. Platinum has dropped below 400, silver is flirting with the five dollar level, and gold drifts listlessly off into the 380 area.

Those who believe inflation is in the air point to rising rents, firming home prices, booming car sales, and, most importantly, to the threat of rising wages.

My own feeling, however, continues to run towards incipient deflation. Unemployment in Europe is running around 11%, Japan is starting to downsize (meaning pink slips), and Asian competition (backed by low wages) is proving to be formidable. I spoke to an old friend in NYC last week, and he tells me that all his textiles are now manufactured overseas at prices that can't be touched here. Thus, he places orders, for instance, to make a fabric in Hong Kong, and the order is shipped, say, directly to Italy. Nothing is manufactured here -- neither the cloth nor the clothes. "It's a different world," he told me, "I'm manufacturing overseas and selling overseas."

So two powerful trends are threatening to take over: (1) Very tough worldwide competition. (2) Too many people and not enough jobs (and computers and robotics will only make #2 worse as time goes on). Both of these, I believe, are long-term deflationary.

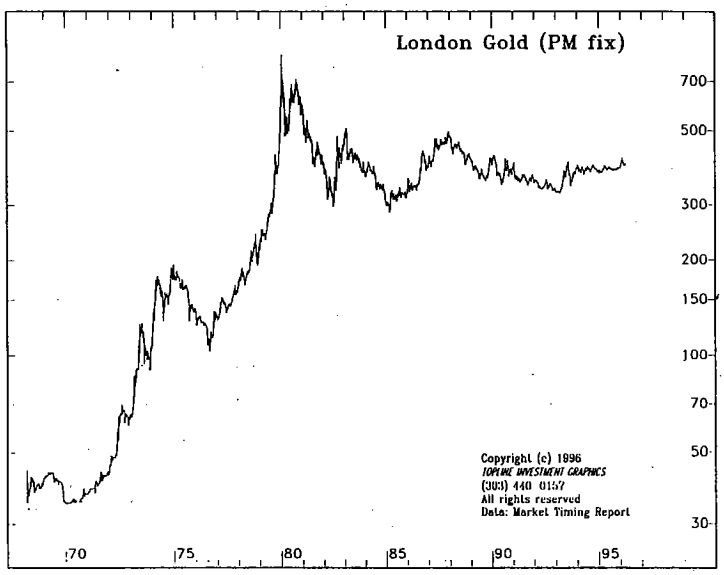
There's an old market adage among we chartists that states, "When the item drops off the bottom of the chart, that's some kind of a signal." Unfortunately, that's what happened to my Gold-Primary Trend Index last week. I started the G-PTI in October 1993. Last week at 511 the G-PTI was at its lowest level since I began this study.



Should holders of gold and gold stocks be discouraged? Frankly, there are only two gold shares whose action I like here, and they are the two shares (traded on the Toronto exchange) that deal in gold royalties, in that they take royalties from other gold mines rather than actually mine gold themselves. These two stocks (often recommended here) are Euro Nevada and Franco Nevada (listed daily in the *WSJ* in Canadian dollars).

Personally, I continue to hold my gold coins, but I hold these as insurance policies, not as a source of great speculative profits. To me, gold coins are like rubies or fine art or a home on Martha's Vineyard -- a hedge against inflation or some other potential disaster.

But what about the loss of interest in holding gold coins? Listen, what about the loss of interest in holding a life insurance policy? Same thing. I read the story about Warren Buffett who, upon spending fours dollars on a fancy gadget, said to his wife, "Do you know what the future value of that same four dollars would amount to 25 years from now?" I mean, c'mon, you can't have ALL your assets drawing compound interest ALL the time. You have to live, you need some insurance, and there's more to life than compounding every asset you own (although, to be honest, the miracle of compounding is mighty attractive and very addicting).



Here's an interesting very long-term ratio chart published by *Topline Investment Graphics* [(303)440-0157]. As you can see, since its 1980 high, gold has been a losing long-term hold. However, interestingly, gold has never dropped below its February 1985 low of 284.

Currently, there are numerous rumors of additional gold sales on the part of the central banks. Obviously, the gentlemen who run the central banks now believe that their own creations, paper money, are worth more than the real thing. Fifty years ago this brand of thinking would have been unbelievable. But the really unbelievable phenomenon is the public's total acceptance of government-manufactured paper, paper that relentlessly erodes in purchasing power over time.

My final thoughts on gold and the precious metals. When market action "feels" so dismal, so darn rotten that you're sorry you ever heard of the item, that's the kind of atmosphere that often identifies a bottom. Gold feels as though it could be at that stage. Gold options -- they're giving 'em away at $160 for the December 410s. Talk about bearishness.

LATE NOTES: Please turn to the page 2 chart. Which are we to believe -- the rebounding Dow, the lagging advance-decline ratio, or the much stronger PTI, which as this is written, is almost sure to record a new bull market high?

Experience tells me that we have to give the vote to the PTI. If Monday, July 1, is a reasonably good "up day" on the NYSE (and it appears it will be), the PTI will register a new high. A new PTI high would be impressive, and it would then be up to the Dow and the advance-decline ratio to confirm.

Another important plus for the market is the strength that is coming from BOTH the bonds and the utilities. Many years ago I published a study of the action of the Bonds and Utility Averages. My conclusion was that any time these two move in unison in the same direction, they almost always carry the rest of the market with them. Note on the page 1 chart that the Utilities have formed a base and moved out while the bonds (see page 4 chart) appear to be ready to follow.

Conclusion: The bull market appears to be intact. Time after time the market backs off and turns erratic. But each time the PTI bucks the trend and pushes up to a new high. When this pattern in the PTI reverses (and some day it will), the market will be in trouble. Until then, the bull remains in command.

NEXT MAILING: July 17, 1996